Financial Markets:

Are we heading back to normality?

Whilst George Soros recently explained "The way out of a deflationary trap is to first induce inflation and then to reduce it" he tried to anticipate the likelihood of a raising yield curve on the back of a recovering economy but also of a massive demand in funding requirements by some governments for their spending programs.

The financial environment we are in faces interesting developments including:

- Shrinking FX turnovers
- Rapid evolution of prime brokerage
- Increased FX volatility
- Shortage in US dollar in global banking
- Slightly increase of the US dollar in currency reserves
- Concerns in clearing and settlement
- Increased international criticism of the greenback
- Developments in algorithmic trading
- Negative interest rates by CB
- New talks about Tobin tax
- ECOFIN meeting ahead
- Raised voices to limit bonus payments (by governmental recommendations so far)

These are all serious issues and besides the actual market developments a lot of politics is involved too – even in our business - which was not guilty in creating this crisis. Let me just touch some of the mentioned above:

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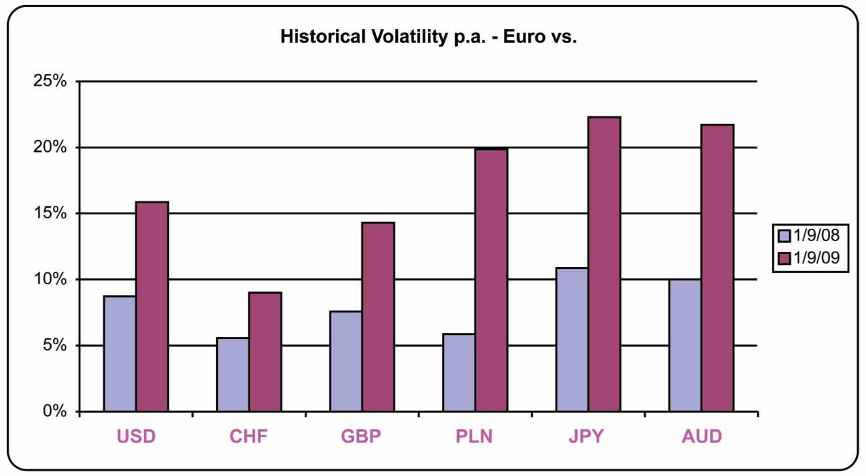
Some economies are showing signs of recovery. Will it be sustainable? Will the financial markets industry find a way back to 'normality'? What will be the consequences for the FX markets? The financial crisis has highlighted just how little is known about the structure of banks' international balance sheets and other issues of interconnectedness. Nowadays we are all waiting for what the regulatory environment comes up with next....

Increased volatility in FX

The recovery in global equity markets between March and August brought volatility in such asset classes down to levels, previously seen before Lehman Brother's failure. The same may not be said about Foreign Exchange in which, although off from the previous highs, volatility in many currency pairs remains high.

The chart below illustrates the volatility (hist. p.a.) of various currencies against the Euro as at 01/09/2009 and 01/09/2008. As one can note, in all currency pairs volatility remains several percentage points higher than a year earlier.



Negative rates by Central Bank

It was interesting to follow the cut into negative interest rates by the Swedish Riksbank on bank deposits recently. I am not aware if any Central Bank before has done so and this might be called a new strategy. This new invention could lead into a new area in financials in particular for seeking ways out of the so-called liquidity trap. Huge amounts of cash still remain trapped within the banking system and do need to find the way to the wider economy. Will other Central Banks follow?

Slight increase of the US in currency reserves

Despite the lack of serious candidates to fill the role of a world-wide reserve currency the US currency will stay dominant. The Euro of course does have a most promising chance to gain further ground. I am watching the development very cautiously and was already examining this point in one of my previous Forewords. We do feel a new vehemence by Russia and China addressing this issue, but being fully aware a falling dollar can not be in the interest of any reserves holder. It is indicated that the share of the US dollar in the world's foreign currency reserves even increased slightly, by 1,4%. Such part of the Euro and Yen is reported to decline partially on the other hand.

Increased international criticism of the greenback

The dollar status as the undisputed no. 1 reserve currency has been under fire for some time. Criticism is predominately coming form the so called BRIC (Brazil, Russia, India, China) countries and a few more. In particular, Russia and China have repeatedly said that they are loosing confidence in the US dollar and have called for the creation of a new reserve currency.

US officials, including two Presidents have repeatedly said that the US supports a strong US dollar policy. The problem is that nobody believes them. Meanwhile, the debt is almost exclusively being bought by foreign Governments, that is to say no private investors and mainly, in short tenors.

Moreover, concerns over the soundness of the US dollar are well justified. Besides the escalating debt and the possibility of induced inflation to lighten the burden of debt, speculation that the US might indeed lose its AAA rating remains.

Should any of the above events materialise, it will bring a steep plunge in the value of the dollar.

ECOFIN meeting ahead

"What priorities are there for the incoming European authorities in light of the financial crisis?" is the theme of 'The Eurofi Financial Froum 2009", which will be held 29 September to 01 October 2009 in Göteborg, Sweden. European financial decision makers will meet on the eve of the Ecofin council to discuss risk management, governance rules, accounting rules, leveraging, investment and hedge funds etc. all aiming to foster future financial stability. In view of the ongoing debates by politicians we might come closer to additional requirements by authorities. We do need to stay tuned here too.

As you can see there are many topics directly or indirectly influencing our business. ACI The Financial Markets Association will take a close look into new developments and will assist our industry in lobbying. I hope you enjoy the many interesting articles within this new issue.